



# Commonwealth of Massachusetts

## Division of Local Services

Supporting a Commonwealth of Communities

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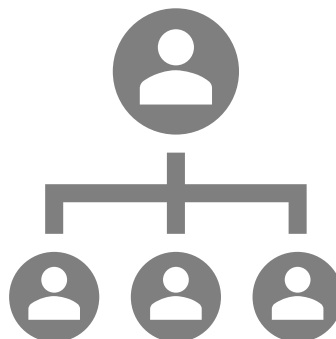
### Audits: An Introduction



## What is an Audit?

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- ❑ Examination of entity's financial records, accounts, business transactions, accounting practices and internal controls
- ❑ Provides independent assurance financial statements are presented fairly and comply with generally accepted accounting principles
- ❑ Review of internal controls
  - Safeguarding assets
  - Ensuring financial statement reliability
  - Promoting operational efficiency
  - Encouraging compliance with management's directives





## What is an Audit?

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- ❑ Appraisal of entity's financial status
  - Assets and liabilities
  - Presents auditor's educated assessment of community's financial position
- ❑ Management Letter explains what was found
- ❑ Preserves integrity of public finance functions
- ❑ Performed by any certified public accounting firm
- ❑ Audit results are public records
- ❑ It is a best practice to have the report presented in a public meeting by the auditing firm





## How Often Should an Independent Audit Be Performed?

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- ❑ The current threshold under the Federal Single Audit Act of 1984, as amended, requires that there be a financial audit or, a specific program audit, if granted by the appropriate federal oversight or cognizant agency whenever \$750,000 or more in federal funds are expended during any one fiscal year
- ❑ MGL 44:42 requires completed audits to be filed with DLS

### **MGL Chapter 44, Section 42:** *Audits by private accounts: required reports*

Section 42. Whenever a city, town or district causes an audit of its accounts or the accounts of separate departments to be made by a firm or person of its own selection, the city, town or district clerk shall immediately, upon the employment of such firm or person, file the name and address with the director, and such firm or person shall, within 10 days after making the report of the audit and recommendations to the city, town or district, file a certified copy thereof with the director.

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## How Often Should an Independent Audit Be Performed?

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- ❑ Continuing Disclosure Annual Report Requirements:
  - No later than 270 days after the end of the fiscal year, audited financial statements must be submitted to the Municipal Securities Rulemaking Board and/or the United States Department of Agriculture if debt is a USDA loan
- ❑ DLS recommends annual independent audits for each community
  - Alternatives available for communities without financial resources available to procure annual audit (e.g., audits every two years with agreed upon procedures engagement in off years, etc.)





## How Often Should an Independent Audit Be Performed?

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- MGL 71:16A requires regional school district to undergo an annual independent financial audit
  - If municipality comprises at least 10% or more of a regional school district, must provide disclosure information annually
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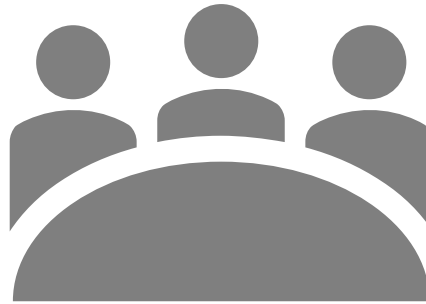
## Selecting an Independent Audit Firm

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- ❑ Decision should be based on municipality's needs and legal requirements
  - ❑ Audit's quality directly related to auditor's knowledge, experience, and professionalism
  - ❑ List of firms that have performed municipal audits can be obtained from:
    - Massachusetts Society of Certified Public Accountants
    - Bureau of Accounts within DLS
  - ❑ Contracting for audit services is exempt from state procurement laws
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## Selecting an Auditor: Audit Committees

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### **Audit Committee**

- Established by many communities to select outside audit firm
- DLS encourages creation of these committees for audit procurement and determining audit objectives





## Selecting an Auditor: Audit Committees

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### **Audit Committee**

- ❑ Subjects of audit (e.g., municipal managers and staff) should not be part of auditor selection process
    - Could include members of finance committee or city council
    - Residents with relevant experience or background
    - Attend exit interview
    - Monitor progress of corrective actions
    - Participate in the audit presentation to the select board or town/city council
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## Selecting an Auditor: Multi-year Agreements

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- GFOA recommends communities engage in multi-year contract with same auditor for at least 5 years
  - Allows for greater continuity
  - Potentially reduce costs in initial years
  - After 5-8 years, municipality should engage in competitive selection process and consider audit firm rotation after each contract, or rotation of senior engagement staff at the same firm if preferred
  - New auditor brings fresh perspective
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## Audit Components

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- Auditor's role is to test and form opinion on accuracy and reliability of a municipality's year-end financial statements
  - Opinion: auditor explains findings
    - "Unmodified opinion": financial statements are fairly presented and comply with applicable framework
    - "Qualified opinion": Financial statements are fairly presented with an exception of a specified area
    - "Adverse opinion": Financial statements are misstated or inaccurate
    - "Disclaimer of opinion": opinion cannot be rendered
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## Audit Components

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- Management Letter: List of internal control weakness and operating inefficiencies
  - Pertinent financial officials should respond to each comment
  - Officials should outline action plans for each citation
  - Work with auditor to uncover root causes of deficiencies
  - Issues should be resolved as soon as possible
  - Measure effectiveness of new measures periodically
  - Be sure to include request for management as part of engagement contract
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## Audit Benefits

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- ❑ Valuable management tool for assessing community's fiscal performance
  - Can reveal underlying causes of financial distress
  - Infrequent audits can lead to decisions based on inaccurate understanding of municipal finances
  - Resource for credit rating agencies
- ❑ Use of report and management letter can assist with improving financial controls and practices





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# Municipal Finance Training

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Division of Local Services

[Mass.gov/dls](http://Mass.gov/dls)